REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SECOND DIVISION

NORKIS TRADING COMPANY, INC., Petitioner,	**CTA CASE NO. 8862**
	Members:
-versus-	**Castañeda, Jr.,** *Chairperson,* **Casanova,** *and* **Manahan,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: AUG 16 2017 8:30 a.m.

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DECISION

CASTAÑEDA, JR., *J.*:

THE CASE

Before this Court is a Petition for Review[1] filed by Norkis Trading Company, Inc. on August 11, 2014, praying for the reversal and setting aside of the Final Decision on Disputed Assessment dated July 9, 2014 of the Commissioner of Internal Revenue and the cancellation and setting aside of the assessment against petitioner in the amount of TWO HUNDRED EIGHTY-FIVE MILLION NINE HUNDRED TWENTY-SEVEN THOUSAND SEVENTY AND 68/100 PESOS (₱285,927,070.68), inclusive of interest and penalties.

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[1] Docket, pp. 14-24.

THE FACTS

Petitioner Norkis Trading Company, Inc. is a corporation duly organized and existing under the laws of the Philippines. It is also registered with the Bureau of Internal Revenue (BIR), with Tax Identification Number (TIN) 000-070-213-000. Petitioner's principal office address is at A.S. Fortuna St., Bakilid, Mandaue City.[2]

On the other hand, respondent Commissioner of Internal Revenue is the head of the Bureau of Internal Revenue, vested under the appropriate laws with the authority to carry out the functions, duties and responsibilities of said office, including the power to decide disputed assessments and cancel and abate tax liabilities pursuant to the provisions of the National Internal Revenue Code (NIRC) of 1997, as amended. He holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

On March 17, 2014, petitioner received a Preliminary Assessment Notice[3] (PAN) dated March 6, 2014, with a proposed assessment of ₱284,253,514.52.

On April 11, 2014, petitioner received the Formal Letter of Demand (FLD) dated April 10, 2014, with the attached Details of Discrepancies and Final Assessment Notice (FAN) No. IT-123-LA0057-07-14-21 from respondent, wherein petitioner was assessed for alleged deficiency income taxes in the amount of ₱285,927,070.68, inclusive of interest and penalties, for its fiscal year ending June 30, 2007.[4]

On May 7, 2014, petitioner filed a protest-letter dated May 2, 2014, as a request for reconsideration, against the Final Assessment Notice.[5]

On July 14, 2014, petitioner received the Final Decision on Disputed Assessment (FDDA) dated July 9, 2014, upholding the deficiency income tax assessment against petitioner.[6]

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[2] Par. 1, Stipulated Facts, Joint Stipulation of Facts and Issues (JSFI), docket, p. 1215.
[3] Par. 3, Stipulated Facts, JSFI, docket, p. 1215.
[4] Par. 4, Stipulated Facts, JSFI, docket, p. 1216.
[5] Par. 5, Stipulated Facts, JSFI, docket, p. 1216.
[6] Par. 6, Stipulated Facts, JSFI, docket, p. 1216.

Accordingly, on August 11, 2014, petitioner filed the instant Petition for Review before this Court.[7] Thereafter, respondent filed his Answer[8] thereto on October 10, 2014.

The case was set for pre-trial conference on November 20, 2014.[9] Respondent and petitioner filed their respective Pre-Trial Briefs on January 12, 2015[10] and on January 20, 2015[11].

On February 10, 2015, the parties filed their Joint Stipulation of Facts and Issues[12], which was later adopted by the Court in the Pre-Trial Order[13] dated February 20, 2015.

During trial, petitioner presented Ms. Mae Elaine T. Bathan,[14] Mr. Wilbert. P. Dumon,[15] Ms. Marisa E. Mar,[16] Ms. Catalina P. Seno,[17] Mr. Ronald G. Alfeche,[18] Mr. Eric D. Borja,[19] Mr. Glenn Ian D. Villanueva,[20] Ms. Marilou V. Cantero,[21] and Mr. Erlan P. Solon[22] as its witnesses.

Subsequently, petitioner formally offered its documentary evidence on August 3, 2015.[23]

On the other hand, respondent presented Ms. Bianca Bess B. Bureros as his lone witness.[24] Thereafter, respondent formally offered his documentary evidence on December 11, 2015.[25]

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[7] Docket, pp. 14-24.
[8] Docket, pp. 79-91.
[9] Notice of Pre-Trial Conference, docket, p. 93.
[10] Respondent's Pre-Trial Brief, docket, pp. 120-124.
[11] Petitioner's Pre-Trial Brief, docket, pp. 139-155.
[12] Docket, pp. 1215-1225.
[13] Docket, pp. 1240-1253.
[14] Minutes of the Hearing dated February 23, 2015, docket, p. 1254.
[15] *Id.*
[16] Minutes of the Hearing dated April 13, 2015, docket, p. 1258; March 18, 2015, docket, p. 1259.
[17] Minutes of the Hearing dated May 4, 2015, docket, p. 1265; dated June 1, 2015, docket, p. 1544.
[18] *Id.*
[19] *Id.*
[20] Minutes of the Hearing dated June 1, 2015, docket, p. 1544.
[21] Minutes of the Hearing dated June 29, 2015, docket, p. 1563.
[22] Minutes of the Hearing dated July 22, 2015, docket, p. 1596.
[23] Formal Offer of Evidence, docket, pp. 1607-1628.
[24] Minutes of the Hearing dated October 26, 2015, docket, pp. 1644.
[25] Docket, pp. 1656-1665.

Respondent filed a Request for Admission via registered mail on July 12, 2016 and received by the Court on July 21, 2016, seeking petitioner's written and sworn response as to the truth of certain matters, namely: (1) the existence of certain bank accounts in the name of petitioner; (2) the deposits made by Yamaha Motors Co. Ltd. to the said accounts on March 9, 2007; and (3) the existence and genuineness of an Indemnity Agreement between Yamaha Motors Co. Ltd. and petitioner.

Petitioner, in its Motion to Expunge and Objections re: Request for Admission[26] filed on July 29, 2016, pointed out that the subject matter of the request for admission was already controverted in earlier pleadings and submissions and that the said request was filed at the late stage of proceedings, hence, should be disallowed and expunged as it has the effect of reopening the case without valid justification.

As directed by the Court, petitioner filed its Memorandum on May 18, 2016.[27] On the other hand, respondent failed to file his Memorandum within the non-extendible period given by the Court.

In the Resolution[28] dated August 30, 2016, the Court granted petitioner's Motion to Expunge and Objections re: Request for Admission, and denied and expunged from the records respondent's Request for Admission.

Hence, on August 30, 2016, the case was declared submitted for decision.[29]

THE ISSUES

The parties submitted the following issues[30] for this Court's disposition:

1. Whether or not the period to assess Petitioner for the amount of ₱285,927,070.68 representing alleged

[26] Docket, pp. 1796-1803.
[27] Docket, pp. 1712-1764.
[28] Docket, pp. 1806-1810.
[29] Resolution dated August 30, 2016, docket, p. 1810.
[30] Issues to be Tried and Resolved, JSFI, docket, p. 1216.

deficiency Income Taxes (inclusive of interest and penalties) for fiscal year ending 30 June 2007 has prescribed.

2. Whether or not Petitioner is liable for the amount of ₱285,927,070.68 representing alleged deficiency Income Taxes (inclusive of interest and penalties) for fiscal year ending 30 June 2007.

PETITIONER'S ARGUMENTS

Petitioner insists that there is no proof, not even *prima facie*, that it received any indemnity fee, and thus, the deficiency tax assessment has no factual basis and must fail. None of the documents formally offered by respondent proves that petitioner received any indemnity fee or remittances from abroad or any amount for that matter. According to petitioner, the Court cannot consider in evidence the Indemnity Agreement and Bank Remittance Documents, which were never formally offered in evidence and were not identified by respondent's witness or marked as exhibits, and which were mere photocopies.

Moreover, petitioner claims that the right to issue the FAN/FLD has prescribed as it was issued more than three years after petitioner's Annual Income Tax Return (ITR) for FY 2006-2007 was filed. Petitioner further contends that there is no actual or presumed fraud that would allow the extraordinary period of ten years under Section 222 of the NIRC of 1997, as amended, to be applicable. Petitioner adds that it was deprived of due process in the issuance of the 2014 PAN, FAN/FLD, and FDDA because respondent refused to provide it with copies of the documents and information needed by petitioner to adequately respond to the 2014 PAN and FAN/FLD. As a result, the FAN/FLD and the decision on the protest or FDDA are null and void.

Furthermore, petitioner avers that assuming *arguendo* that any indemnity may have been received, an indemnity by its nature does not constitute income because there is no gain or profit from the receipt of any proceeds arising from an indemnity agreement. Similarly, it could not have given rise to any tax liability in petitioner's FY 2006-2007, because the amounts that would have been received under the alleged Indemnity Agreement would have been meant to reimburse and recompense for damages and losses arising from the termination of the exclusive arrangements for the distribution of Yamaha motorcycles. There would be taxable income arising from the receipt of such an indemnity only if the amounts received exceeded the damages and losses that they were meant to reimburse and recompense. And flowing from this rule, taxable income can be realized only in the taxable year when it is or can be determined that the amount of the indemnity received does or would exceed the damages, losses, and expenses that are intended to be indemnified.

RESPONDENT'S ARGUMENTS

Meanwhile, in his Answer[31], respondent argues that the three-year prescriptive period is inapplicable since there was substantial under-declaration of taxable income. Hence, the period to assess petitioner has not yet prescribed because respondent has ten years to assess petitioner from the discovery of the false or fraudulent return filed by petitioner.

Respondent insists that the final assessment is valid and that petitioner is liable for under-declared income. He likewise asserts that the issuance of the tax assessment was compliant with the provisions of the NIRC of 1997, as amended, and Revenue Regulations (RR) No. 12-99. Respondent further posits that as regards the indemnity agreement, petitioner cannot feign innocence as to its existence considering that its President, Mr. Norberto Quisumbing, Jr., represented and signed for and on behalf of petitioner. He adds that while it is true that due process requires that the taxpayer must be informed of the basis of the assessment, it does not necessarily mean that respondent is required to furnish taxpayers of the documents upon which the assessment was based.

Furthermore, respondent argues that the alleged indemnity fee is taxable income and is subject to tax, pursuant to Section 32 of the NIRC of 1997, as amended. gc

[31] Docket, pp. 79-91.

THE COURT'S RULING

Section 203 of the NIRC of 1997, as amended, provides that the government can assess internal revenue taxes within three (3) years from the last day prescribed by law for the filing of the tax return, or the actual date of filing of such return, whichever comes later. Hence, an assessment notice issued after the three (3)-year prescriptive period is invalid and ineffective. Section 203 of the NIRC of 1997, as amended, is quoted hereunder for ready reference:

> "SEC. 203. *Period of Limitation Upon Assessment and Collection.* – Except as provided in Section 222, internal revenue taxes shall be assessed within three (3) years after the last day prescribed by law for the filing of the return, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period: *Provided*, That in a case where a return is filed beyond the period prescribed by law, the three (3)-year period shall be counted from the day the return was filed. For purposes of this Section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day."

Nevertheless, as can be gleaned from Section 203 of the NIRC of 1997, as amended, there are certain exceptions to the period of limitation of assessment and collection of taxes. Section 222 of the NIRC of 1997, as amended, provides that:

> "SEC. 222. *Exceptions as to Period of Limitation of Assessment and Collection of Taxes.* –
>
> (a) **In the case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years after the discovery of the falsity, fraud, or omission: *Provided*, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof.**
>
> (b) If before the expiration of the time prescribed in Section 203 for the assessment of the tax, both the Commissioner and the

> taxpayer have agreed in writing to its assessment after such time, the tax may be assessed within the period agreed upon. The period so agreed upon may be extended by subsequent written agreement made before the expiration of the period previously agreed upon.
>
> (c) Any internal revenue tax which has been assessed within the period of limitation as prescribed in paragraph (a) hereof may be collected by distraint or levy or by a proceeding in court within five (5) years following the assessment of the tax.
>
> (d) Any internal revenue tax, which has been assessed within the period agreed upon as provided in paragraph (b) hereinabove, may be collected by distraint or levy or by a proceeding in court within the period agreed upon in writing before the expiration of the five (5)-year period. The period so agreed upon may be extended by subsequent written agreements made before the expiration of the period previously agreed upon.
>
> (e) *Provided, however*, That nothing in the immediately preceding Section and paragraph (a) hereof shall be construed to authorize the examination and investigation or inquiry into any tax return filed in accordance with the provisions of any tax amnesty law or decree." *(Emphasis supplied)*

Petitioner contends that the right to issue the FAN/FLD has prescribed as it was issued more than three years after petitioner's ITR for FY 2006-2007 was filed. It argues that there is no fraud because there is no factual basis in support of the allegation that it received the amount of $6,000,000.00, which alleged receipt is the only basis of the present assessment.

On the other hand, respondent avers that there was substantial under-declaration of taxable income; and thus, he has ten years to assess petitioner from the discovery of the false or fraudulent return filed by petitioner.

It must be stressed that fraud is a question of fact, and thus, should never lightly be presumed. To be sustained, the same must be supported by clear and convincing proof because it is a serious charge.[32]

[32] *Commissioner of Internal Revenue vs. Asalus Corporation*, CTA EB No. 1191, July 30, 2015, citing *Commissioner of Internal Revenue vs. Mitsubishi Corporation-Manila Branch*, CTA EB No. 640, September 16, 2011.

In the case of *Commissioner of Internal Revenue vs. B.F. Goodrich Phils., Inc. (now Sime Darby International Tire Co., Inc.) and the Court of Appeals*[33], the Supreme Court had the occasion to discuss the concept of falsity and rule that the fact that a taxpayer sold its real property for a price less than its declared fair market value did not by itself justify a finding of false return. The High Court held:

> "Petitioner insists that private respondent committed 'falsity' when it sold the property for a price lesser than its declared fair market value. This fact alone did not constitute a false return which contains wrong information due to mistake, carelessness or ignorance. It is possible that real property may be sold for less than adequate consideration for a *bona fide* business purpose; in such event, the sale remains an 'arm's length' transaction. In the present case, the private respondent was compelled to sell the property even at a price less than its market value, because it would have lost all ownership rights over it upon the expiration of the parity amendment. In other words, private respondent was attempting to minimize its losses. At the same time, it was able to lease the property for 25 years, renewable for another 25. This can be regarded as another consideration on the price.
>
> **Furthermore, the fact that private respondent sold its real property for a price less than its declared fair market value did not by itself justify a finding of false return.** Indeed, private respondent declared the sale in its 1974 return submitted to the BIR. Within the five-year prescriptive period, the BIR could have issued the questioned assessment, because the declared fair market value of said property was of public record. This it did not do, however, during all those five years. **Moreover, the BIR failed to prove that respondent's 1974 return had been filed fraudulently. Equally significant was its failure to prove respondent's intent to evade the payment of the correct amount of tax.**
>
> Ineludibly, the BIR failed to show that private respondent's 1974 return was filed fraudulently with intent to evade the payment of the correct amount of tax. Moreover, even though a donor's tax, which is defined as 'a tax on the privilege of transmitting one's property or property rights to another or others without adequate and full valuable consideration,' is different from capital gains tax, a tax on the gain from the sale of the taxpayer's property forming part of capital assets, the tax return filed by private respondent to report its income for the year 1974 was sufficient compliance with the legal

[33] G.R. No. 104171, February 24, 1999.

requirement to file a return. In other words, the fact that the sale transaction may have partly resulted in a donation does not change the fact that private respondent already reported its income for 1974 by filing an income tax return.

Since the BIR failed to demonstrate clearly that private respondent had filed a fraudulent return with the intent to evade tax, or that it had failed to file a return at all, the period for assessments has obviously prescribed. Such instances of negligence or oversight on the part of the BIR cannot prejudice taxpayers, considering that the prescriptive period was precisely intended to give them peace of mind." *(Emphasis supplied)*

Furthermore, in the case of *The Commissioner of Internal Revenue vs. Obayashi Philippines Corporation*,[34] the Court of Tax Appeals *En Banc*, citing the CTA Division ruling, held:

"False or fraudulent return as an exception to the period of limitation and to collect taxes provided in Section 222 of the National Internal Revenue Code of 1997 [formerly Section 223], must be actual not constructive. It must be intentional, consisting of deception willfully and deliberately done or resorted to. Fraud must be proven by clear and convincing evidence amounting to more than mere preponderance. It cannot be justified by mere speculation. This is because fraud is never lightly to be presumed *(Yutivo Sons Hardware Company v. Court of Tax Appeals and Collector of Internal Revenue, 1 SCRA 160).* In order to render a return made by a taxpayer a 'false return' within the meaning of Section 222 of the Tax Code, there must appear a design to mislead or deceive on the part of the taxpayer, or at least culpable negligence. A mistake, not culpable in respect of its value would not constitute a false return *(Commissioner of Internal Revenue vs. Ayala Hotels, Inc., CA-G.R. SP No. 70025, April 19, 2004.)"*

In the instant case, respondent alleges that petitioner did not reflect the receipt of $6,000,000.00 in its ITR for FY 2006-2007. He asserts that since the gross sales per ITR for the year 2007 is ₱920,370,006.00, there is substantial under-declaration of 31.06% due to the non-declaration of the indemnity fee of $6,000,000.00 or ₱290,880,000.00.[35] *gr*

[34] CTA EB No. 42, June 10, 2005.
[35] At ₱48.48 exchange rate on March 9, 2007.

However, records indicate that respondent failed to provide any evidence showing that petitioner indeed received such amount as indemnity fee, as respondent offered only the following documents as evidence:

EXHIBIT	DESCRIPTION
R-1	Memorandum of Assignment No. 123-13-07-00106 dated 24 July 2013
R-2	Annual Income Tax Return with attached Financial Statement of Petitioner
R-3	Memorandum Report recommending the issuance of LOA
R-4	First Notice
R-5	Letter from Petitioner dated 7 October 2013
R-6	Second and Final Notice
R-7	Letter from Petitioner dated 3 December 2013
R-8	Memorandum Report recommending the issuance of Preliminary Assessment Notice
R-9	Memorandum Report recommending the issuance of Final Assessment Notice and Formal Letter of Demand
R-10	Final Assessment Notices
R-11	Formal Letter of Demand with Attached Details of Discrepancies
R-12	Memorandum Report recommending the issuance of Final Decision on Disputed Assessment
R-13	Final Decision on Disputed Assessment with Attached Details of Discrepancies
R-14	Judicial Affidavit of Bianca Bess B. Bureros
R-14-a	Signature of Bianca Bess B. Bureros

In fact, the Indemnity Agreement between petitioner and Yamaha Motors Co. Ltd. was the subject of respondent's Request for Admission filed through registered mail on July 12, 2016, but which was denied and expunged from the records by the Court in its Resolution dated August 30, 2016. Jr

Considering that respondent failed to prove that there was an Indemnity Agreement and/or that petitioner received the amount of $6,000,000.00 as indemnity fee, there is no proof as to the alleged substantial under-declaration and/or commission of fraud in the present case. Thus, Section 203 of the NIRC of 1997, as amended, will apply and the prescriptive period of three years will govern.

Records show that petitioner filed its ITR for FY 2006-2007 on October 13, 2007.[36] Since petitioner's fiscal year ended on June 30, 2007, the last day to file its ITR for that year was on October 15, 2007. Hence, counting three years from petitioner's last day to file the ITR, the BIR had until October 14, 2010. However, petitioner received the FAN/FLD only on April 11, 2014, which is clearly beyond the prescriptive period given to assess. Considering that the assessment was made beyond the prescriptive period, the assessment is void.

As regards the other issues raised, this Court deems it no longer necessary to resolve the same.

WHEREFORE, premises considered, the instant Petition for Review is **GRANTED**. Accordingly, respondent's Final Decision on Disputed Assessment dated July 9, 2014 is hereby **REVERSED** and **SET ASIDE**, and the assessment under FAN No. IT-123-LA0057-07-14-21 in the amount of ₱285,927,070.68, inclusive of interest and penalties, is hereby **CANCELLED** and **SET ASIDE**.

SO ORDERED.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice

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[36] Exhibit "P-14".

WE CONCUR:

CAESAR A. CASANOVA
Associate Justice

CATHERINE T. MANAHAN
Associate Justice

ATTESTATION

I attest that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, and the Division Chairperson's Attestation, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

ROMAN G. DEL ROSARIO
Presiding Justice